# Economic Outlook: Cautious Optimism

A Virtual Conversation with Philadelphia Federal Reserve

President Patrick T. Harker

Risk Management Association, Philadelphia Chapter

Philadelphia, PA (virtual)

September 29, 2021

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Good morning! It's great to be back with this group, though given that we're meeting virtually, we unfortunately had to make it a BYOB — bring your own *breakfast*, I mean, of course.

I note that the title of this event is "A Virtual Conversation with Philadelphia Federal Reserve President Patrick T. Harker," and I'm really looking forward to that part of the morning. But before we get to the Q&A, I'd like to sketch out just a few brief remarks about the state of the national economy and the path of Federal Reserve policy.

But before I can even do that, there is another bit of Fed policy I must adhere to. And that is the standard Fed disclaimer: The views I express today are my own and do not necessarily reflect those of anyone else on the Federal Open Market Committee or in the Federal Reserve System.

For the past 18 months, the U.S. economy has moved in tandem with the waxing and waning of the COVID-19 pandemic. During periods when case rates and hospitalizations have declined, the economy has surged as American consumers have voted with their feet — and their wallets. When COVID-19 risks abate, more Americans dine out at restaurants, check in to hotels, and — much to the chagrin of their fellow passengers who were hoping to stuff their luggage in the overhead compartment — fill up airplanes. Those are important categories of spending in a country where consumption makes up about 70 percent of total economic activity. In the second quarter of this year, for instance, GDP grew at a very healthy annualized rate of around 6.5 percent as case rates plummeted.

And, of course, the opposite occurs during periods when the virus spikes. When the Delta variant of COVID-19 erupted, fomenting the country's fourth major wave of the pandemic, things started moving sideways. Consumer confidence tanked, and large industries like hospitality and leisure stagnated at best. So for this quarter, we can expect growth to come in at an annualized rate of between 3 and 4 percent, a sharp slowdown from earlier this year.

But there are reasons to be sanguine that the country's recovery from this wave of COVID-19 may prove more durable than in the past. You're a group of risk management professionals, so I probably don't need to tell you this, but vaccines are by far the most effective way to mitigate the risks of both catching — and also getting seriously ill — from the virus.

The good news here is that more than half the country is fully vaccinated. In our tri-state region, meanwhile, vaccination rates are above the national average. Getting more shots into arms will save lives and aid the recovery by reducing the size and severity of future COVID-19 waves. The Delta variant has also concentrated minds: It seems to have not only persuaded more Americans to get shots on their own, but it also pushed more corporations and institutions to mandate their employees to get vaccinated. That is cause for optimism.

Still, headwinds remain. Supply chain constraints are a powerful one, as shortages of crucial parts like computer chips have hobbled not only the production of cars and trucks, but also comparatively smaller durable goods like home appliances. (Yes, there are computer chips in your washing machine; we've come a long way since the days of the washboard.) One of our business contacts, a major homebuilder, tells us he's now selling new homes with used appliances in them with the promise that he'll replace them as soon as he can. Manufacturers in our region are also reporting being hamstrung by supply chain issues. Unfortunately, there are indications that these constraints could persist for the next couple of years.

There's another input lacking in supply as well: labor. Job openings are at record highs, hitting nearly 11 million at the end of July. Meanwhile, more people are quitting their jobs, and the rate at which open positions are being filled is continuing to slow. The upshot, of course, is better pay for those who *are* working: Wages are up more than 4 percent year over year.

It's clear that a combination of factors — trouble accessing childcare or eldercare, lingering fears about the virus, the rise in equities and home values spurring people to retire, and perhaps a general revaluation of life choices — is persuading a lot of Americans to stay on the sidelines even as the economy has reopened. And notably, the elimination of extra federal unemployment benefits has not noticeably — at least not yet — appeared to nudge people back into the workforce.

So, where does all of this leave us? For 2021, I would expect GDP growth to come in at around 6.5 percent. It will then moderate to about 3.5 percent in 2022, and 2.5 percent in 2023. Inflation, meanwhile, should come in around 4 percent for 2021 — we're already seeing some moderation there, as prices of used cars finally stabilize. After that, we can expect inflation of a bit over 2 percent for 2022 and right at 2 percent in 2023. Unemployment should fall steadily during this period as well.

Downside risks include persistent supply chain issues or yet another resurgence of the virus. And in the short term, a failure by Congress to raise the debt ceiling could harm economic growth significantly.

In terms of monetary policy, I am in the camp that believes it will soon be time to begin slowly and methodically — frankly, *boringly* — tapering our $120 billion in monthly purchases of Treasury bills and mortgage-backed securities. Those purchases were necessary to keep markets functioning during the acute phase of the crisis. But to the extent that we are still dealing with a labor force issue, the problem lies on the supply side, not with demand. You can't go into a restaurant or drive down a commercial strip without noticing a sea of "Help Wanted" signs. Asset purchases aren't doing much — or anything — to ameliorate that.

After we taper our asset purchases, we can begin to think about raising the federal funds rate. But I wouldn't expect any hikes to interest rates until late next year or early 2023.

Now, before we move to our Q&A, I'd like to share just a little bit of information from our most recent *CFI COVID-19 Survey of Consumers*. One of the pleasures of this job is sharing some of the research we do with audiences like you.

Since April 2020, the Philadelphia Fed has been conducting a series of national surveys that focus on changes in job status, income levels, and personal financial security. The economic data we have access to at the Fed — and believe me, we look at a *ton* of data — are an extraordinary resource. But it's important, too, to understand how people's economic realities are playing out on the ground. Our COVID-19 surveys have been instrumental in allowing us to do that.

I'd encourage all of you to take a look at our series of surveys on our website — philadelphiafed.org — but I'd like to point out just a few important data points from the latest survey, which was done this summer as Delta surged.

First, more people were feeling more confident about their personal finances this summer than they were in the spring. More were working normal hours, and more were working onsite, rather than remotely; 10.9 percent of respondents reported being currently laid off or furloughed, down from 17.9 percent last fall.

But when it came to expectations about the future, the survey found wide disparities across groups. Women, people making less than $40,000 a year, and people under the age of 36 were much more pessimistic about their earnings over the next year than men and older people, for instance. The good news is, across all survey respondents, the number of people reporting they are having trouble making ends meet has been declining.

The headline of this iteration of the survey is “Cautious Optimism Reigns,” which I’d say captures my sentiment regarding the economy as well.

So, thanks again so much for having me. And now, let’s move on to questions.